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DISCUSSION

The ECJ's First Bitcoin Decision: Right Outcome, Wrong Reasons?

JULIE MAUPIN — 19 November, 2015

On 22 October 2015, the Court of Justice of the European Union issued its first ever ruling on the digital currency known as Bitcoin. For those who haven't been following this phenomenon, Bitcoin was the first and so far remains the most commercially successful of the recent wave of 'cryptocurrencies'– a term defined by the online Oxford Dictionary as 'a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank'.

The latter element helps explains why cryptocurrencies and their derivative technologies may well prove incapable of effective state-based regulation. If one considers in addition the facts that the technologies are:

- decentralized (over peer-to-peer networks);
- globally distributed (like the internet, but without geospatially-linked IP addresses); and
- pseudonymous (thanks to the encryption),

it's easy to see why they might be natural candidates for some kind of international or transnational rather than national regulatory regime. This suggestion quickly gets tricky, of course; it is difficult to think of many policy areas more central to the historical concept of sovereignty than control over the nation's money supply. Still, the short annals of cryptocurrency uses and abuses suggest that some kind of cross-border regulation of the technologies is warranted.

In point of fact, until this month's Economist cover story painted virtual currencies in a considerably more favorable light, most people had heard about them only in connection with illicit activities. Last year, for example, a group of Swiss artists made the news when their robot 'Random Darknet Shopper' – whom they had supplied with a weekly budget of $100 worth of Bitcoins – managed to purchase 'a Hungarian passport, Ecstasy pills, fake Diesel jeans, a Sprite can with a hole cut out in order to stash cash, Nike trainers, a baseball cap with a hidden camera, cigarettes and the "Lord of the Rings" e-book collection', all before being arrested in a sting operation by the St. Gallen police. Less entertaining reports of cryptocurrency uses (like drug trafficking, money laundering, and terrorist financing) unfortunately also abound.

The EJC case

It may therefore come as a surprise that the CJEU's first foray into this veritable digital revolution involved something as mundane as the European VAT directive. A Swedish national, Mr. Hedqvist, sought to open up a company in Sweden enabling customers to exchange traditional currencies for Bitcoins and vice versa. The company planned to make its money in the usual manner of currency exchanges: on the margin between bid and ask prices. Mr. Hedqvist had obtained a preliminary opinion from the Swedish Revenue Law Commission stating that the services he intended to provide would be exempt from VAT under Article 135 of the European VAT Directive. The Swedish Tax Authority disagreed, however, and appealed the matter to the Supreme Administrative Court of Sweden. Uncertain as to how to apply the Directive's exemptions to virtual currencies, the Swedish court referred the matter to the CJEU for a preliminary ruling.

To paraphrase paragraph 21 of the CJEU's judgment, two questions were referred:

1. Is the exchange of virtual currency for traditional currency and vice versa a service effected for consideration under Article 2 (1) of the VAT Directive?
2. If so, should Article 135(1) of the Directive be interpreted to mean that such transactions are nevertheless tax exempt?

The Court's findings

Not surprisingly, the Court answered the first question in the affirmative. Buying and selling a currency on margin is a form of supply of services for consideration. This, as the Court pointed out, was fairly obvious under the ECJ's prior

settled case law. Hence, in principle, cryptocurrency trading should be subject to VAT unless it falls under one of the Directive's enumerated exemptions.

But here's where the analysis gets interesting. Notice that embedded in the Court's answer to the first question is the conclusion that Bitcoin is indeed a currency – and not, as some have argued, a commodity, a speculative asset, a contract or property right, or some other form of legally enforceable claim against others. According to paragraph 24 of the Court's opinion:

"the 'bitcoin' virtual currency with bidirectional flow, which will be exchanged for traditional currencies in the context of exchange transactions, cannot be characterised as 'tangible property'... given that, as the Advocate General has observed... that virtual currency *has no purpose other than to be a means of payment*." (Emphasis added.)

This last phrase will no doubt come as a surprise to the many individuals and firms who have already made and lost small fortunes investing in Bitcoin, using it as a hedge against real currency fluctuations, and layering all kinds of for-profit products and services on top of the Bitcoin blockchain (the latter being the underlying technological innovation that makes the whole thing work). The same can be said of pretty much all other cryptocurrencies in use today. They can and do serve as means of payment, of course, but it does not therefore follow that their purposes and uses stop there.

The gross oversimplification which the Court indulged in with its sweeping statement becomes even more obvious when considering how it answered the second of the

referred questions: whether any of the VAT Directive's article 135(1) exemptions should apply to a cryptocurrency exchange like the one proposed by Mr. Hedqvist.

Here, after paying homage to the usual interpretive niceties, the Court followed the Advocate General's opinion in homing in on article 135(1)(e) of the VAT Directive as the relevant provision, which reads:

"(1) Member States shall exempt the following transactions: [...] (e) transactions... concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items... which are not normally used as legal tender or coins of numismatic interest".

The source of the Swedish court's confusion is easy to spot upon reading this text. The difficulty lies in the words "legal tender". While it may be reasonable to regard Bitcoin as a type of currency (even if from a technological standpoint it is not *only* that), it is quite plainly not *legal* tender. Neither Sweden nor any other country in the world yet accepts it as such.

The CJEU sidestepped this problem with a classic European law move: linguistic differences. The AG had noted that although the German version requires all of the exchanged currencies to be legal tender in order to qualify under the exemption, the English version might allow for only one of them to be legal tender, the Finnish version might require only bank notes and coins (but not currencies) to be legal tender, and the Italian version might not care about the legal status of any of them. It does not take a doctorate in EU law to recognize that when the Finnish translation is mentioned, we have entered the territory of purposive interpretation.

On this basis, the Court held that Mr. Hedqvist's transactions would be VAT exempt.

Fair enough. The Directive, after all, dates from 2006, and Bitcoin didn't enter circulation until 2009. The Court had little choice but to come up with a sensible way of applying the former to the latter.

Parsing the reasoning

Slightly more troubling, however, was the Court's speedy disposal of paragraphs (d) and (f) of article 135(1). Those paragraphs exempt:

"(d) transactions… concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments…

(f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods…"

As it happens, Bitcoin is a type of distributed ledger which can be used to keep track of all of the things mentioned in (d) – in other words not only Bitcoin transactions themselves, but also non-Bitcoin "debts, cheques and other negotiable instruments". The Bitcoin network can likewise function as a means of establishing title to all of the things mentioned in (e). The government of Honduras, for example, is busy figuring out how to transition all of the country's real property titles onto a public blockchain. Nasdaq is using private blockchains to keep track of the assets traded on its private shares market.

A recent World Economic Forum survey even predicted that by 2023 the first governments will begin collecting taxes via blockchains, and by 2025 over 10% of global gross domestic product will be stored on blockchains. There are, in short, many possible uses of the technology "other than to be a means of payment". Some of those uses may well be VAT exempt under various provisions of the European VAT Directive; others won't be exempt at all.

The CJEU's opinion in the Hedqvist case is thus likely to be only the opening regional salvo in the barrage of global legal quandaries to come. It is the lot of courts to pour new wine into old wine skins. Lawmakers, policymakers, and the academics who advise them, on the other hand, should start thinking long and hard about whether what we are drinking is wine at all anymore.

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